


John Glen MP
Economic Secretary to the Treasury
1 Horse Guards Road
Westminster
London SW1A 2HQ

By email

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**Buy Now Pay Later**

As you know, in September 2020, the FCA Board asked me to conduct a review into change and innovation in the unsecured credit market. The scope of the review included innovations in credit products which fall outside the FCA's regulatory perimeter and potential changes to the regulatory system about which the FCA may wish to advise other authorities or the Government.

My report will be sent to the FCA Board later this week, but there is an urgent point relating to interest-free Buy Now Pay Later (referred to here as BNPL) credit agreements which I want to raise with you immediately, given the passage of the Financial Services Bill. I have discussed this point with Charles Randell, who agrees that I should write to you now; he will write to you separately with the Board's views on BNPL, once the Board has met on 28 January. I would expect my report and the FCA Board's initial reactions to it to be published on or around 2 February.

BNPL is a rapidly growing product. The BNPL agreements in question are currently exempt from the requirements of the Consumer Credit Act and are not regulated by the FCA.

As you are aware from the debate on the Financial Services Bill, there is significant public interest in this topic. There is demand from consumer groups for regulation and several BNPL providers have even said they would 'welcome' regulation.

These products can be useful, but they can also be harmful if used poorly. There is a significant risk that without appropriate oversight the market may develop in a way which is not beneficial for consumers or the wider credit market.

Based on the work of the Review, I am going to recommend that exempt BNPL credit agreements are brought within the FCA's perimeter. Given the pace of growth in the market, I believe this recommendation needs to be acted upon with real urgency.

Why regulate?

Data shared with the FCA by some of the main BNPL providers showed the volume of transactions using BNPL had more than tripled between January and December 2020. We've seen evidence of spikes in usage correlating with both the April and November 2020 lockdowns. Although average single transaction values are relatively low (between £65-£75), the popularity of the product is quickly increasing and the potential consequences for harm are therefore growing. Multiple transactions using multiple providers are possible without affordability checks or transparency such that it would be relatively easy to accrue around £1,000 of debt without that being visible to credit reference agencies or to all mainstream lenders. Some retailers offer a choice of five or more providers at the point of checkout and we know from our own research that BNPL users will shop around if refused credit with one of them.

Some have put the argument to the Review that part of the use is being driven by younger consumers who prefer specific transaction products to a line of credit like a credit card, which our research suggests is partly true. However, it is also the case that the product is being used by those who would otherwise struggle to obtain new credit. Evidence obtained from a major bank by the Review showed that of their customers recording a transaction with a BNPL firm in November 2020, more than 1 in 10 of those customers were already in arrears with mainstream lenders.

This market has established itself largely by relying on exemptions within legislation, and now is the time to act in a proportionate way to mitigate harms and ensure consumers can continue to use these products safely.

This recommendation will require legislative change, which I return to below. This is an opportunity to act with pace, to mitigate the potential harms which may be arising in this market.

Benefits and the potential harms of exempt BNPL credit agreements

To inform the Review, and in coming to this conclusion, we commissioned qualitative research to understand consumer perceptions of the product, the drivers of use and the potential harms which may arise. Questions on BNPL products were included in the Review's call for input and I met with the CEOs of some of the main BNPL providers in the market.

When BNPL is provided to a consumer who can afford to repay on time, the consumer does not directly bear the charge for credit; instead, firms obtain revenue from both retailers and (in most cases) from fees to consumers who do not pay on time. Some of the consumers who use BNPL might otherwise finance their purchase using a very costly form of credit. Therefore, this type of lending does have a use and the aim of regulation should be to mitigate the potential harms in the market whilst placing it on a sustainable footing.

Nonetheless, the Review has identified a number of potential harms which suggests the current exemption is not appropriate:

- **Poor consumer understanding of the different BNPL products** – consumers often didn't view it as credit, associating it more with payment technologies.

- **Consumers think they are protected and assume the product is already regulated** – although consumers don't necessarily view exempt BNPL agreements as credit, they do view it as a financial service and expect that it therefore comes with the associated rights and protections, e.g. being able to refer complaints to the Financial Ombudsman Service.
- **BNPL market structure can focus on outcomes for the retailer rather than the borrower** – BNPL providers market themselves to retailers on the basis that consumers spend more when they use a BNPL credit agreement compared to traditional payment methods. There is a risk the overall consumer journey is designed with the interests of the retailer, rather than borrower, in mind.
- **Presentation of BNPL offers can make it hard for consumers to make an informed decision** – they can be presented as the default payment option, or in a long-list of options which are hard to differentiate between, and the consequences of not repaying are often buried in terms and conditions.
- **Insufficient protection for vulnerable consumers** – a number of common symptoms of mental health problems can make it harder to manage money and control spending. There is a risk there is insufficient protection for vulnerable consumers who use these products, particularly those who have mental health problems. In the regulated market, a combination of FCA guidance and voluntary action by firms does offer some additional protection.
- **Lack of proper affordability assessments** – although most BNPL providers complete some kind of very basic credit assessment, most providers focus on credit risk rather than genuine affordability.
- **Lack of visibility of BNPL liabilities for other lenders** – most providers do not report repayment history to credit reference agencies which may mean other lenders do not have a complete view of a consumer's financial position when assessing affordability.
- **Potential to create high-levels of indebtedness** – although average transaction values are relatively low, consumers can have multiple outstanding agreements across different providers and some providers are looking to partner with retailers selling higher-value items.
- **Expansion of BNPL providers' offering** – some BNPL providers are looking to expand their offering beyond online retail platforms, to allow consumers to utilise their products in store. This may compound existing risks around consumer understanding of the consequences of the product and the conduct of in-store staff.

Objectives of a new regulatory regime

The exemption under which BNPL firms currently operate was set out in the Consumer Credit Act 1974, primarily to support short-term invoice deferral. The exemption was never intended for this kind widespread use in the retail sector and a range of non-financial firms still use this exemption for short-term payment deferral. It is important that any changes to regulation should be proportionate and non-financial firms using the exemption as intended shouldn't inadvertently be brought within the perimeter, whilst also having a clear grip on BNPL.

My Review team colleagues, your officials and respective legal advisers have been discussing how such a change could be made in terms of primary or secondary legislation and I would hope we can conclude those conversations very shortly.

The effect of this would be to bring BNPL fully within the FSMA regime. I believe this is the most sensible and proportionate response rather than trying to create a special regime for it.

The regulatory regime should ensure consistency of outcomes in relation to products which consumers use in substitutable ways or where similar harms are present. There needs to be an appropriate degree of consumer protection. Regulation should seek to ensure affordability is appropriately assessed and address the treatment of consumers in financial difficulty.

Advertising shouldn't encourage the use of credit for frivolous purchases and shouldn't trivialise the nature of the product. Good work has been done here by the ASA in relation to the advertising of some BNPL products, but under the full financial promotions regime under FSMA, BNPL lenders would have to give sufficient information about the product and be clear, fair and not misleading.

I believe we can secure these goals by adopting the approach I have outlined.

I am also copying this letter to Charles Randell and Gwyneth Nurse. Given the public interest in this matter, I would also propose to publish a copy of this letter at the same time as the publication of my report.

Yours,
Chris

Christopher Woolard CBE

**Chair, Review of Change and Innovation
in the Unsecured Credit Market**

cc Charles Randell CBE, Chair Financial Conduct Authority

Gwyneth Nurse CB, Director Financial Services, HM Treasury